ECONOMY AND FINANCE • VOL. 9. ISS. 2. • JUNE 2022 • DOI: 10.33908/EF.2022.2.9

EXCHANGE RATES AND DEBT MANAGEMENT – MY PROFESSIONAL RECOLLECTIONS OF WERNER RIECKE

Gábor Oblath[1]

My first personal encounter with Werner Riecke – and his fellow author, *István Ábel* – was preceded by a first encounter of a professional focus. In his memory, I will recall that intellectual encounter first, and then look back on how our views on external debt management differed – and eventually converged. Although I have many other memories of Werner, as we were working together for many years in the Monetary Council of the central bank of Hungary, these two are the most vivid.

FOREIGN TRADE PRICE COEFFICIENT VS RATE OF EXCHANGE

In 1980, an essential paper was published in Volume XXVII Issue 2 of the *Közgazdasági Szemle* [Economic Review] with the title *'Exchange rate, enterprise profit-orientation and efficiency in foreign trade'* [Árfolyam, nyereségérdekeltség és külkereskedelmi hatékonyság]. The authors were two young economists of my age, István Ábel and Werner Riecke. I did not know the authors personally but got extremely curious upon seeing that title as I was researching the exact same topic at KOPINT back then. It was nice to read the first footnote of the paper which was as follows: 'After preparing our manuscript, a paper by István Lakos and Gábor Oblath […] was published, which often follows a similar line of thought as our paper.'

Our paper *'Rate of exchange and the foreign trade price coefficient'* [A valutaárfolyam és a külkereskedelmi árszorzó], co-authored with *István Lakos*, was published a few months before in Issue 6 of 1979 of the *Külgazdaság* [External Economic Bulletin], and indeed, the ideas it contained were in many respects similar to those in István Ábel's and Werner's paper. We also tried to make our point with reference to the dispute recurring from the mid-1960s on about the average rate of exchange and the marginal rate of exchange. Both they and us argued that the so called 'average rate of exchange', i.e. a rate of exchange aligned to the average

1 Gábor Oblath, Centre for Economic and Regional Studies, Institute of Economics. E-mail: oblath.gabor@krtk.hu.

costs for exporters to produce a unit of foreign exchange and the related system of subsidies, is not reasonable from an economic point of view and results in loss of efficiency. And as they, we also aimed at using novel concepts and a language more suitable for illuminating the relevant economic relationships.

Upon reading their paper, I had to admit with more than a tinge of envy that we were bested by the Ábel–Riecke duo in terms of approach and choice of concepts. We argued fundamentally verbally for the same ideas proposed by István and Werner. By contrast, they offered a graphic, intuitive and more easily understandable way of explaining the same meaning we were trying to convey to readers in lengthy paragraphs.

Re-reading that article after 42 years, I still find it a flawless piece of work. It had an importance not only for economic governance at the time (or would have, had it received due attention), but also for all developing countries having a *de facto* multiple exchange rate regime in place (which, in fact, was widespread in that period). Let me highlight two fundamental losses of efficiency, which are easily conceivable based on the authors' figures.

- A foreign trade price coefficient, determined at a level substantially lower than the "equilibrium" (or, as it was known, marginal rate of exchange) in alignment with the average costs of producing a unit of foreign exchange, renders exports slightly less efficient than that price coefficient unprofitable, but enables (even expressly supports) exports substantially less efficient.
- *De facto* export rates higher than import rates may render even exports of minimal or negative domestic value added profitable. In the extreme, this would have the consequence that the growth of certain exports activities paradoxically deteriorates the foreign trade balance.

I believe that the paper by István and Werner published in 1980 not only put the domestic, fairly parochial – and based on the standard concepts of economics, hardly understandable – dispute about the average vs marginal rate of exchange into an appropriate conceptual framework, but also conveyed important international messages. *Paul Marer* tried to make these messages available to a wider audience. Recognising the importance of the paper, he provided an insightful analysis of its most important results in the 1981 issue of the so-called 'Green Book', a yearly publication on Eastern Europe for the U.S. Congress.

EXTERNAL DEBT AND DEBT MANAGEMENT

The other decisive professional recollection I have of Werner brings back the topics and atmosphere of an economic conference held two decades later, in 1992, by the Centre for Economic Policy Research (CEPR) in London. Both Werner and I had a presentation at that conference on Hungary's external debt. At the time, it was a serious issue whether servicing Hungary's inherited debt, exceptionally high as a proportion of GDP in a Central European context, would not drain Hungary's economic resources to an extent that prevents putting its economy on a growth path. Many considered it an insupportable burden, and many others – both in Hungary and abroad – advocated that the Hungarian economy has no chance to recover from the grave recession of 1990–1991 without 'debt relief' (rescheduling, write-off, etc.).

Presentations and contributions at the conference appeared in writing in the volume *Hungary: An economy in transition*, published in 1993 (eds. *Székely P.*, *István* and *Newbery, David M.,* Cambridge University Press, CEPR). That volume provides me a point of reference, allowing me to compare my memories with the published texts.

Both my memories and a re-examination of our relevant papers in the volume clearly show that the views Werner and I had at the time on managing external debt were very far apart. Using a monetary approach to the balance of payments, applied to the Hungarian economy, Werner proposed that it would be sufficient to keep new domestic lending below the rate of increase of domestic demand for money. He believed back then that this could ensure that the amount of currency needed for Hungary's debt service would be available, since economic agents would have to satisfy their demand for money partly from abroad (e.g. in the form of an export surplus), which necessarily leads to availability of the currency needed for part of the debt service.

I did not agree with his argument. As I saw it, there was a need for two types of transfers simultaneously in order to pay Hungary's external debt. First, a redistribution of resources from the private to the public sector. Second, a real transfer abroad, i.e. an export surplus should be realised by the economy as a whole. Back then, at a time of decreasing production, that dual transfer seemed an extremely hard task, and therefore it was just logical for *Richard Portes*, one of the discutants of our presentations, to conclude that there was no point in struggling, and Hungary should apply for debt relief.

At that point, Werner and I were on the very same page. Although our views differed in many respects, we were both convinced that any gesture implying that Hungary is not willing to service its foreign debt would do serious harm. Werner had more confidence in monetary relations, while I considered the supplementary source of finance provided by rising FDI inflow to be the potential solution. Notwithstanding, we both believed that not meeting Hungary's debt service would only harm the country, without any substantial benefits. As far as I can remember, we did not succeed in convincing our foreign 'benefactors', but that does not matter anyway.

What does matter is that the *Antall* administration resisted diverse pressures from abroad and, most importantly, from within borders, and chose not to apply for debt rescheduling, which was always followed by grave recession, as shown by international experience. Werner and I strived jointly to avert that danger of recession by putting forward arguments on a professional footing.

The untimely death of Werner Riecke is an aching loss for the community of Hungarian economists. His wisdom, valuable insights and gentle irony remain in the memories of all who knew and loved him.